

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

REBUTTAL TESTIMONY OF

JAMES M. PROCTOR

**ON BEHALF OF
GREAT PLAINS ENERGY INCORPORATED
AND
KANSAS CITY POWER & LIGHT COMPANY**

**IN THE MATTER OF THE JOINT APPLICATION OF GREAT PLAINS ENERGY
INCORPORATED, KANSAS CITY POWER & LIGHT COMPANY,
AND WESTAR ENERGY, INC. FOR APPROVAL OF THE ACQUISITION OF
WESTAR ENERGY, INC.
BY GREAT PLAINS ENERGY INCORPORATED**

DOCKET NO. 16-KCPE-593-ACQ

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I. INTRODUCTION AND PURPOSE

Q: Please state your name and business address.

A: My name is James M. Proctor and my business address is 5555 West 6th Street, Suite Q5, Lawrence, Kansas 66049.

Q: On whose behalf are you submitting this testimony?

A: I am submitting this rebuttal testimony (“Rebuttal Testimony”) before the Kansas Corporation Commission (“Commission” or “KCC”) on behalf of Great Plains Energy (“GPE”), a Kansas City Power & Light Company (“KCP&L”) and Westar Energy, Inc. (“Westar”, including Kansas Gas & Electric Company or “KGE”), the (GPE, KCP&L and Westar are referred to collectively herein as “Joint Applicants”) regarding Joint Applicants’ request for Commission approval of GPE’s acquisition of Westar (the “Transaction”).

Q: Please describe your educational background and experience in the energy and utility industries.

A: Please see the attached Schedule JMP-1 for my educational background and experience in the energy and utility industries.

Q: Please expand on your experience while serving as the Chief of Accounting and Financial Analysis for the Kansas Corporation Commission.

A: I was employed by the Commission from August 1984 to October 31, 1990. Thus, I was the Chief of Accounting and Financial Analysis for the KCC Staff on July 23, 1990, when KCP&L announced a tender offer to purchase all outstanding common shares of KGE (Docket No. 172,745-U). I was also the Chief of Accounting and Financial Analysis when KPL and KGE announced the execution of a merger agreement on October 28, 1990 (Docket No. 174,155-U). As discussed below, these dockets were consolidated and

1 form the basis for the establishment of the Commission's Merger Standards in an Order
2 issued on November 14, 1991 ("1991 Merger Order), after I had left the Commission to
3 assume my role at the Oklahoma Corporation Commission.

4 **Q: What is the purpose of your Rebuttal Testimony?**

5 A: The purpose of my testimony is to respond to the testimony of Staff witnesses
6 McClanahan, Gatewood, Grady and Hempling regarding the Commission's Merger
7 Standards (a)(ii) and (a)(iv), particularly as they apply to the Acquisition Premium
8 ("AP"). I will also reply to Staff witnesses McClanahan, Diggs, Grady, Hempling and
9 Glass as they relate to Merger Standard (a)(iii) related to the quantification of merger
10 savings. I will describe the origin of these particular standards and subsequent application
11 in merger cases over the past twenty-five years. Finally, I will describe how these
12 standards should be applied to the facts and circumstances presented in this application.

13 **Q: How is your testimony organized?**

14 A: Section II provides an executive summary, including my principal conclusions and
15 recommendations. Section III reviews the development and application of the
16 Commission's Merger Standards over the years. Section IV addresses the attempt by
17 Staff to apply the rules applicable to gains on sales of utility assets to the Transaction.
18 Section V discusses the level of support the Commission has required in the
19 determination of savings anticipated to be generated by a merger. Section VI sets forth
20 my conclusions.

II. EXECUTIVE SUMMARY

21 **Q: Please provide an Executive Summary of your Rebuttal Testimony.**

22 A: The Merger Transaction ("Transaction") yields an Acquisition Premium ("AP") of
23 approximately \$4.9 billion, as estimated by Joint Applicant witness Busser in his direct

1 testimony. Although GPE is not seeking to recover any portion of the AP in rates, Staff
2 has concluded that the acquisition does not meet Merger Standard (a)(ii) or Merger
3 Standard (a)(iv) as they relate to the reasonableness of the purchase price and the
4 payment of an AP. Staff has separately proposed that its asserted “gain” on sale be, in
5 effect, “taxed” and paid to Kansas customers of Westar. Both proposals are inconsistent
6 with the original intent and subsequent application of the Merger Standards in every
7 merger decision that has been issued over the past twenty-five years. I also testify that
8 many transactions have been approved by the Commission when estimated merger
9 savings were less than the AP even when recovery of a portion of the AP was being
10 requested, which is not the situation in this Transaction, and have not been subject to the
11 level of scrutiny that has been proposed by Staff in this docket.

12 The Commission has never required that merger saving be “demonstrated,” to the
13 degree of specificity and planning detail that Staff and Intervenor argue should be
14 required here, by the applicants for approval of a merger transaction. In fact, merger
15 savings estimates and analyses very similar to those relied upon and presented by GPE in
16 this proceeding have been adopted previously by the Commission. Customers will benefit
17 from the Transaction as cost savings, net of requested recovery of transition costs directly
18 incurred to achieve such savings, are fully reflected in the respective revenue
19 requirements used for determining utility rates of Westar’s and KCP&L’s Kansas
20 customers through the ratemaking process.

III. MERGER STANDARDS

1 A. Introduction

2 **Q: What testimony of Staff and intervenor witnesses do you address in this section of**
3 **your rebuttal testimony?**

4 A: I respond to the testimony of Staff witnesses McClanahan, Gatewood, Grady and
5 Hempling regarding the Commission's Merger Standards (a)(ii) and (a)(iv):

6 (a) The effect of the transaction on consumers including:

7 (ii) Reasonableness of the purchase price, including whether the purchase
8 price was reasonable in light of the savings that can be demonstrated
9 from the merger and whether the purchase price is within a
10 reasonable range; and

11 (iv) Whether there are operational synergies that justify payment of a
12 premium in excess of book value.

13 Before addressing these two elements of the Merger Standards, it is necessary to review
14 the initial development of the Merger Standards, beginning with the seminal 1991 order.

15 **Q: What purpose do Merger Standards serve?**

16 A: The Commission must consider the public convenience and necessity, often referred to as
17 the "public interest" in applications brought before it. This is required of the Commission
18 whether the particular application pertains to a utility rate case or a proposed utility
19 merger transaction. However, the Commission's governing statutes do not provide any
20 further guidance concerning how it is to determine whether a merger application is in the
21 public interest.

22 Because of the broad language of its governing statutes, it was up to the
23 Commission to establish more definitive merger standards to provide guidance for parties

1 seeking approval of a transaction; the Commission has done so in a series of orders over
2 the years. In the 1991 Merger Docket, the Commission issued its order on November 14,
3 1991 (“1991 Merger Order”) adopting a set of merger standards (factors to weigh and
4 consider in determining whether a merger transaction promotes the public interest). As
5 noted elsewhere in my testimony, I was employed at the KCC when these dockets were
6 filed. The Commission reaffirmed (with one modification) the Merger Standards in its
7 Order issued September 28, 1999 in Docket No. 97-WSRE-676-MER (“1999 Merger
8 Docket” and “1999 Merger Order”, respectively). The Commission has acknowledged
9 that while the standards provide a helpful framework for its analysis of the public
10 interest, some factors may be less relevant than others in certain proceedings.¹ Since
11 these Merger Standards are not enacted by the legislation, the specific content and
12 application of them may change or evolve over time as the Commission enters orders on
13 specific merger applications. The Commission has acknowledged that while the
14 standards provide a helpful framework for its analysis of the public interest, some factors
15 may be less relevant than others in certain proceedings.²

16 **Q: What will you establish through your discussion of the Commission’s merger**
17 **orders?**

18 A: I will demonstrate that the Commission has applied Merger Standards (a)(ii) and (a)(iv)
19 to determine the amount of the AP, based on merger savings, which should be recovered
20 through utility rates. Contrary to the position taken by Staff, these standards were not
21 designed to determine whether the purchase price or acquisition premium is reasonable
22 for the purpose of granting, or denying, a merger transaction.

¹ 1991 Merger Order, pages 34-36.

² 1991 Merger Order, pages 34-36.

1 **B. Discussion of Commission Precedent**

2 **1. Commission Precedent: 1991 Merger Order**

3 **Q: Please provide some background concerning the Kansas Power and Light Company**
4 **and Kansas Gas and Electric Company merger in 1991.**

5 A: On July 23, 1990, KCP&L announced a hostile tender offer to purchase all outstanding
6 common shares of Kansas Gas and Electric Company (KGE)³ and subsequently filed an
7 application to the KCC for approval of the merger.

8 On October 28, 1990, Kansas Power and Light Company (“KPL”) and KGE
9 announced the execution of a competing, “friendly” merger agreement. On November
10 20, 1990, KPL and KGE filed a joint application requesting approval of their proposal to
11 merge, pursuant to the Commission’s general regulatory authority.⁴

12 On November 21, 1990, the Commission issued an order (a) consolidating the
13 competing applications of KCP&L (Docket No. 172,745-U) and KPL/KGE (Docket No.
14 174,155-U. On December 13, 1990, KCP&L filed a withdrawal of its application
15 wherein it notified the Commission of the withdrawal of its unsolicited tender offer to
16 acquire KGE.

17 On November 14, 1991, the Commission issued its order finding the merger of
18 KPL and KGE “as proposed is unacceptable because it does not promote the public
19 interest and, as such, is hereby rejected.” However, the Commission further found:

20 Even so, a merger between KPL and KGE presents the
21 Commission with a rare opportunity to achieve material and
22 significant cost savings. As proposed, however, the savings would
23 go primarily to the stockholders of the Applicants and very little
24 would flow to consumers. Consequently, the proposed merger will
25 be approved with a rigid set of conditions that will work to ensure

³ Docket No. 172,745-U

⁴ Docket No. 174,155-U

1 that customers of KPL and KGE receive their equitable share of
2 savings generated by the merger.⁵

3 **Q: What was your role with the Staff in reviewing the transactions discussed above?**

4 A: As Chief of Accounting and Financial Analysis, it was my responsibility to develop the
5 conceptual framework and strategy to review, evaluate and provide recommendations to
6 the KCC regarding all accounting and financial issues, and associated regulatory policy
7 in the KCP&L/KGE docket. Most significantly, for purposes of the current GPE
8 proceeding, this framework was used in the 1991 Merger Order approving the merger of
9 KPL and KGE for quantifying the amount of the AP recoverable through rates post-
10 closing.

11 **Q: Please explain your approach for reviewing the AP.**

12 A: The framework involved a comparison of estimated after-tax cost savings directly
13 attributable to the merger transaction to the dollar amount of the estimated AP to be paid
14 in KCP&L's tender offer to KGE's shareholders for purposes of determining the
15 maximum amount of AP to be recovered from Kansas customers.⁶ The methodology
16 involved identifying merger synergies, and estimating the nominal dollar value of the
17 after-tax cost savings which flow from synergies, over future annual periods, and
18 calculating the net present value of such annual savings amounts using an appropriate
19 discount rate.

20 The estimated net present value of the merger's cost savings represents the
21 maximum amount of the AP which should be recoverable through the post-transaction
22 utility companies' rates from customers. That is, the net present value of the merger's
23 cost savings represents the expected maximum amount of the AP which should be

⁵ 1991 Merger Order, page no. 106

⁶ Cost savings directly attributable to the merger transaction are often referred to as savings from merger synergies.

1 recoverable through rates in order to establish the level of recovery which leaves the
2 customers, as a whole, at least as well off from the merger transaction as it relates to their
3 utility rates.⁷ Having determined the maximum amount of recoverable AP to be included
4 in utility rates, the framework contemplated that the Commission may allow recovery for
5 a somewhat lesser amount based on risk considerations. The framework also
6 contemplated that the recovery of the AP could be accomplished either by the direct
7 inclusion of the AP in KCP&L's and KGE's rate base or recovery of the acquisition
8 premium in KCP&L's and KGE's revenue requirements in an amount equal to the net
9 present value of the estimated merger savings benefits.

10 **Q: Did the Commission apply your framework in the 1991 Merger Order?**

11 A: Yes. In the 1991 Merger Order, the Commission explained and analyzed the relationship
12 of merger savings, the net present value of merger savings, risk and fairness, to the
13 sharing of merger benefits and other regulatory treatment of the AP. As explained in the
14 1991 Merger Order:

15 The Commission believes that ratepayers will reap the benefits of
16 synergies that result from the overlapping service territories of
17 these two utilities. The Commission, with the conditions it imposes
18 in this order, restructures the transaction to minimize those risks
19 for the ratepayers and to the extent that risks exist, properly places
20 them upon the shareholders, who authorized their managements to
21 undertake this venture. Although the Commission's primary
22 responsibility is to protect the ratepayers, the Commission believes
23 that the merger also provides shareholders with the opportunity to
24 realize benefits. The Commission thus issues the merged company
25 a challenge. The merged company will have to be aggressive in
26 cutting costs and generating revenues through off-system sales.
27 However, if they meet this challenge, as the Commission is
28 convinced they are prepared to do, they have the opportunity to

⁷ The use of the qualifier "expected" here indicates risk and error exist in the estimation of the various variables and assumptions used to quantify the net present value of merger savings. The existence of risk, along with fairness considerations, is a motivating factor for allowing the post-transaction company(s) to recover something less than the expected net present value of costs savings through rates.

1 experience growth that the stand-alone entities would not have had
2 the ability to achieve.⁸

3 The Commission also stated on page 2 of the 1991 Merger Order that “As a result,
4 the Commission imposes conditions to limit recovery of the AP to an amount that reflects
5 the realistic level of savings that the Commission believes can be achieved by the merged
6 company,” and on page 49 of the Order that “The Commission believes the appropriate
7 regulatory treatment of the AP is to tie the potential recovery of the AP to benefits that
8 will be realized by ratepayers as a result of the merger. In this case, the amount of the AP
9 to be included in rates shall be tied to the savings reasonably projected to be generated by
10 the merger.”

11 **Q: Did the Commission make any judgment as to whether the purchase price or AP**
12 **was reasonable?**

13 A: No. The Commission made no judgment about the reasonableness of the purchase price
14 or the AP. Further, the Commission did not base its approval for the KPL/KGE merger
15 on the reasonableness of purchase price or AP. In fact, the Commission found: “that the
16 basis of the AP was not the projected savings. The Commission is persuaded that KPL's
17 \$ 32/share offer was the result of KPL's white knight response to KCPL's hostile takeover
18 attempt. The evidence is clear that KPL made the \$ 32/share offer in an effort to win the
19 bid for KGE.”⁹

20 **Q: Did the Commission establish a requirement that the merger savings expected to be**
21 **generated by the merger equal or exceed the acquisition premium?**

22 A: No. In the 1991 Merger Order the Commission did not establish a requirement that the
23 cost savings expected through merger synergies equal or exceed the AP paid in a merger

⁸ 1991 Merger Order, page 2.

⁹ 1991 Merger Order, page 48.

1 to satisfy Merger Standards (a)(ii) and (a)(iv). Further, the Commission did not establish
2 a requirement that any minimum percentage amount of the AP must be offset by merger
3 savings. No conditional relationship at all between merger approval and purchase price or
4 AP was established in the 1991 Merger Order.

5 **Q: Did the Commission express any view with respect to the size of the AP, other than**
6 **determination of the amount that could be recovered through rates?**

7 A: No. The Commission found that a reasonable estimate of merger savings was in the
8 range of \$306 to \$315 million and that the actual AP to be paid by KPL was significantly
9 larger – approximately \$388 million – a figure that “could change significantly depending
10 on the KPL stock price and the net book value of KGE at the time of consummation of
11 the merger.”¹⁰ However, the Commission did not raise any concern about the size of the
12 AP, stating only that

13 [T]he Commission believes that ratepayers should be responsible
14 for no more than the reasonably determinable benefits which they
15 can with some certainty expect from the transaction. Consequently,
16 whether the actual AP paid by KPL is more or less than \$388
17 million should not affect the amount recoverable through rates.
18 Since the Commission has found that \$ 312 million represents the
19 cost savings which are reasonably anticipated from the merger, that
20 is the AP which will be permitted, subject to the allocation
21 procedures discussed below.¹¹

22 In fact, the Commission approved the merger knowing that the actual AP would exceed
23 the Commission’s estimate of the merger savings. The Commission approved the merger,
24 thus allowing customers to benefit from merger savings, but limited KPL’s recovery of
25 AP to the net present value of estimated merger savings.

¹⁰ 1991 Merger Order, page 60.

¹¹ 1991 Merger Order, pages 60-61.

1 **Q: What specific treatment did the Commission authorize for recovery of merger**
2 **savings?**

3 A: The amount allowed for recovery was tied to the estimated level of merger savings,
4 which the Commission found was \$312 million. The company was allowed to amortize
5 the \$312 million of the AP over 40 years without carrying costs or rate base treatment of
6 the unamortized balance resulting in an annual amortization expense of \$12.7 million a
7 year . The company could recover this amount in future rates only to the extent it had
8 merger savings of at least \$12.7 million. However, if merger savings were greater than
9 \$12.7 million, the amount above that level was to be shared between customers and
10 shareholders on a 50/50 basis. The Commission justified the 50/50 sharing stating that it
11 would “provide Applicants with an opportunity to recover the carrying costs of the
12 allowed AP while minimizing the financial pressure on the merged company.”¹² The
13 Commission found that “[t]he risk of achieving savings sufficient to earn a return of or on
14 the allowed AP is entirely on the Applicants.”¹³

15 **Q: Do the Commission’s findings in the 1991 Merger Order comport with your**
16 **assertion regarding the application of Merger Standard (a)(ii) and (a)(iv)?**

17 A: Yes, they do. The proper application of Merger Standard (a)(ii) and (a)(iv) is that these
18 elements of the Merger Standards should be used to determine an amount of the AP
19 which may be recovered in rates, if any, based on merger savings. These elements of the
20 Merger Standards do not establish the maximum AP that could be paid for the transaction
21 or to determine whether the transaction should be approved by the Commission. Rather,
22 the after-tax net present value of the merger’s cost saving represents the maximum

¹² *Id.* at 83.

¹³ *Id.* at 83-84.

1 amount of the AP which should be recoverable through the post-transaction utility
2 company' rates from customers. Limiting recovery to the net present value of the
3 merger's cost savings establishes the level of recovery which leaves the customers, as a
4 whole, unaffected from the merger transaction as it relates to their utility rates. As applied
5 in the KPL/KGE case, the proper application of Merger Standards (a)(ii) and (a)(iv) was
6 to the limit the recovery of the AP based on merger savings to a reasonable amount not to
7 second-guess KPL on its negotiated purchase price.

8 **2. Commission Precedent: 1999 Merger Order**

9 **Q: Does the Commission's review of the proposed WRI/KCP&L merger shed any**
10 **additional light on this issue?**

11 A: Yes. In its 1999 Merger Order, the Commission approved the merger of WRI and
12 KCP&L.¹⁴ Once again, as in the 1991 Merger Order and a subsequent 1997
13 Western/KGE Order which modified recovery of the AP originally set in the 1991
14 Merger Order, the Commission did not find that anticipated cost savings, in net present
15 value terms, were equal to or greater than the AP. Further, the Commission did not
16 require, for approval of the transaction, that cost savings, in net present value terms, must
17 be equal to or greater than the AP.

18 **Q: Did the Commission's 1999 Merger Order discuss the reasonableness of the**
19 **purchase price or AP?**

20 A: No. In fact, in its Order, *the Commission did not even mention the amount of the AP or*
21 *purchase price being offered by WRI for KCP&L's common equity.* The Commission's
22 order approving the merger application with modifications focused largely on the merger

¹⁴ Even though the merger of Western Resources and KCP&L was approved by the Commission, with modifications, Western Resources and KCP&L terminated the transaction.

1 savings, net present value of merger savings and the sharing of these cost benefits
2 between WRI and its ratepayers. Once again, the Commission's application of its Merger
3 Standards with respect to evaluating the premium focused on the quantification of the net
4 present value of cost savings from merger savings and how those benefits should be
5 allocated between the utility and its customers. The Commission did not interpret and
6 apply Merger Standards (a)(ii) and (a)(iv) to evaluate the reasonableness of the purchase
7 price or the AP as a basis for approving, or denying, the merger.

8 **Q: Was regulatory treatment of the AP a matter of contention in the proposed**
9 **WRI/KCP&L merger that led to the 1999 Merger Order?**

10 A: Yes. I testified on behalf of Staff in that merger proceeding and estimated the AP as
11 approximately \$1.16 billion. The Joint Applicants, Commission Staff, City of Topeka
12 and the International Brotherhood of Electric Workers, AFL-CIO, Local No. 304
13 proposed a document entitled Joint Recommendations, Stipulations, and Agreement
14 ("Joint Recommendation") that would have placed \$300 million of the AP in rate base,
15 allowing a return on and of that amount in rates. However, because there was no
16 unanimous stipulation and agreement, the case went to a full evidentiary hearing after
17 which the Commission rejected the Joint Recommendation while approving the
18 transaction under different terms.

19 **Q: How did the Commission rule concerning the AP in that proceeding?**

20 A: The Commission decided to permit the applicants the opportunity to recover a portion of
21 the AP through retention of some of the savings that can be directly tied to the merger.¹⁵

22 As I explain above, the Commission did not make any finding concerning the
23 reasonableness of the AP to be paid in the transaction. Instead, the Commission focused

¹⁵ 1999 Merger Order, paragraph 25.

1 on anticipated merger savings. The Commission ultimately found the after-tax, net
2 present value of the savings (on a total company basis) to be \$358.9 million.¹⁶

3 In approving the merger, the Commission stated it “finds that the savings and
4 benefits from the merger are one of the primary reasons why the merger is in the public
5 interest. The Commission further finds that these savings should be shared between the
6 utility company and its customers.”¹⁷ The Commission allowed the merged company to
7 recover a portion of the AP through a four-year rate moratorium,¹⁸ and the amortization
8 of \$179.45 million of AP on “a straight-line basis over a period of 35 years commencing
9 at the time new rates are filed at the end of the moratorium. This amount is
10 approximately one-half of the estimated merger savings.”¹⁹

11 It should be emphasized that the Commission, in explicitly allowing the merged
12 company to recover a portion of the AP through the rate moratorium, allowed the use of
13 regulatory lag to recover a portion of the AP – a practice criticized by Staff witness
14 Hempling in his testimony in this proceeding.²⁰

15 **Q: Please summarize this precedent, focusing on the points that are particularly**
16 **relevant in this proceeding.**

17 A. It is clear from the relevant precedent that the Commission has not reviewed merger
18 savings and the AP in merger transactions to evaluate the reasonableness of the purchase
19 price. Instead, in evaluating a merger’s AP and estimated cost savings under Merger
20 Standards (a)(ii) and (a)(iv), the Commission has limited such review to determine the

¹⁶ 1999 Merger Order, paragraph 27.

¹⁷ 1999 Merger Order, paragraph 28.

¹⁸ 1999 Merger Order, paragraphs 31-32.

¹⁹ 1999 Merger Order, paragraph 34.

²⁰ Scott Hempling Direct, at 104.

1 maximum amount of AP that should be recovered through post-transaction rates. Again,
2 I would note that Joint Applicants have not requested rate recovery of the AP.

3 **Q: Has the Commission addressed the applicability of these Merger Standards in this**
4 **docket?**

5 A. Yes. In this docket, in an order issued on August 9, 2016, the Commission reaffirmed the
6 Merger Standards.²¹ In that Order, the Commission also stated that any deviation from
7 the standards in a merger application would need to be identified and justified²² and that
8 “Similarly, if Staff or an intervenor believes the standards need to be modified in a
9 particular docket, they are obligated to explain the proposed modification and provide the
10 grounds supporting the proposed modification.”²³

11 **3. Application of the Precedent to Merger Standard (a)(ii)**

12 **Q: Please summarize the issues addressed in Mr. Grady’s testimony concerning**
13 **Merger Standard (a)(ii), the reasonableness of the purchase price?**

14 A: In evaluating Merger Standard (a)(ii), Mr. Grady considered the following factors: 1)
15 whether Westar’s enterprise value or “purchase price” is commensurate with other recent
16 utility merger transactions according to certain valuation multiples; and 2) whether the
17 agreed-upon purchase price is reasonable given the operational synergies or cost savings
18 that can be demonstrated from the merger. The former topic is addressed by Joint
19 Applicant witnesses Robert Hevert and Kevin Bryant. A portion of my rebuttal
20 testimony will focus on the latter topic.

²¹ Order on Merger Standards, Docket No. 16-KCPE-593-ACQ, at ¶ 5 (“2016 Merger Standards Order”).

²² *Id.* at ¶7.

²³ *Id.*

1 **Q: In your opinion, is Mr. Grady’s second issue relevant for purposes of applying**
2 **Merger Standard (a)(ii) to this Transaction?**

3 A: No. In my opinion, Mr. Grady should have concluded his examination of Merger
4 Standard (a)(ii) and found that that Merger Standard had been satisfied because the
5 purchase price is within a reasonable range as discussed in detail in the testimonies of
6 Joint Applicant witnesses Robert Hevert and Kevin Bryant. That is because the aspect of
7 Merger Standard (a)(ii) addressing “whether the purchase price was reasonable in light of
8 the savings that can be demonstrated from the merger” is only applicable when the
9 acquiring utility in a merger seeks recovery of the AP, based on merger savings, through
10 post-Transaction rates. This is consistent with the original intent and subsequent
11 application of Merger Standard (a)(ii). While it is relevant when the applicants are
12 seeking specific ratemaking recognition of an AP based on merger savings in its post-
13 transaction utility rates,²⁴ the Joint Applicants are not seeking such ratemaking authority
14 in their merger application here.

15 **Q: What was Mr. Grady’s conclusion from his review of whether the “purchase price**
16 **can be justified by the operational synergies or cost savings”?**

17 A: Mr. Grady concluded that the purchase price agreed to be paid by GPE for Westar’s
18 common stock could not be determined reasonable in light of the savings that can be
19 demonstrated from the Transaction.²⁵ However, his conclusion is not relevant to this
20 Transaction.

²⁴ When a utility makes an investment in goodwill, or an acquisition premium, and desires to recover the revenue requirements for that investment in rates, it may do so, if allowed by a commission, by including the intangible asset recorded for the premium in rate base and the amortization of the asset in operating expenses. Sometimes a commission allows only partial recovery of the investment or a surrogate collection methodology.

²⁵ Justin Grady Direct, at 40-41.

1 **Q: What is Mr. Grady’s position concerning Merger Standard (a)(iv), “whether there**
2 **are operational synergies that justify payment of a premium in excess of book**
3 **value”?**

4 A: Mr. Grady believes there are not sufficient cost savings from the Transaction to justify
5 GPE’s payment of the \$4.9 billion AP over Westar’s book value.²⁶

6 **Q: Do you agree with Mr. Grady’s application of Merger Standard (a)(iv)?**

7 A: No. Since GPE is not requesting inclusion of the AP in rates, the same reasoning applies
8 to Merger Standard (a)(iv). As I described in my review of the precedent, my conclusion
9 is consistent with the original intent and subsequent application of Merger Standard
10 (a)(iv). Similar to my comments about Mr. Grady’s testimony for Merger Standard
11 (a)(ii), that comparison and measure was originally established and meant to be relevant
12 for merger transactions where the purchaser seeks to recover through inclusion in
13 customer rates some or all of the AP based on the merger’s cost savings.

14 **Q: Do you have any other comments with respect to Mr. Grady’s application of Merger**
15 **Standard (a)(iv)?**

16 A: Yes. Mr. Grady concludes the merger savings are lower than what would be appropriate
17 to support an AP of \$4.9 billion. As I noted earlier, previous Commission orders have not
18 required estimated merger savings be at least as much as the AP paid. Some of these
19 orders do not even mention the amount of the merger savings or AP.

20 **Q: Should the Commission have any concern about the purchase price paid in utility**
21 **mergers?**

22 A: Yes. Merger Standard (a)(i) provides the vehicle for that review. The standard provides
23 that the Commission will review:

²⁶ Justin Grady Direct, at 41.

1 (a) The effect of the transaction on consumers including:

2 (i) The effect of the proposed transaction on the financial condition of
3 the newly created entity as compared to the financial condition of
4 the standalone entities if the transaction did not occur.
5

6 Where the merging companies indicate they will not seek recovery of AP in rates, the
7 Commission's concern for the purchase price should only be related to an inquiry
8 concerning the impact of the price on the post-merger entity's financial health. Joint
9 Applicant witness Mr. Bryant addresses that issue in his Direct and Rebuttal Testimony
10 and demonstrates that the financial condition of Westar and KCP&L post-Transaction
11 will be maintained, or in the case of GPE will remain investment grade, if the Transaction
12 is approved as requested. However, it must be emphasized, that is an entirely different
13 matter than asking whether a merger should be denied if the net present value of
14 estimated merger savings is less than the AP implicit in the transaction's purchase price.

15 **Q: Will GPE seek to recover the AP or other transaction-related costs in its utility**
16 **rates?**

17 A: No. I understand that GPE will not seek to recover a return on or amortization of the AP
18 or of its transaction costs through either its Westar's or KCP&L's Kansas utility rates.
19 However, the recovery of the AP could resurface as an issue in a post-Transaction rate
20 case if another party seeks to base Westar's or KCP&L's rates on the GPE consolidated
21 capital structure.

22 **Q: The applicants have reserved the right to seek recovery of some amount of the AP if**
23 **a party in a future ratemaking proceeding seeks to use the GPE consolidated capital**
24 **structure as the basis for determining rates. Does that affect your analysis?**

25 A: It would only affect my analysis if the Commission finds that Westar's and KCP&L's
26 capital structures should not be used to set post-Transaction rates for Westar and KCP&L

1 but that GPE's consolidated capital structure should be used instead, and no AP is
2 recovered through inclusion in rates.

3 **Q: Has a party to this proceeding proposed to base Westar's or KCP&L's rates on the**
4 **GPE consolidated capital structure?**

5 A: Yes. Staff has made such a recommendation through its witness Mr. Gatewood. He
6 recommends that GPE's consolidated capital structure be used for determining Westar's
7 and KCP&L's rates post-Transaction.²⁷ Joint Applicant witness Hevert addresses this issue
8 in his rebuttal testimony.

9 **Q: Would it be appropriate to include some of the AP in Westar's and KCP&L's rates if**
10 **the consolidated capital structure post-Transaction is used for determining their**
11 **weighted-cost of capital for rate making purposes?**

12 A: Yes. One explanation is based on simple accounting concepts. It is clear Mr. Gatewood
13 believes that GPE will receive financial benefits from the financing employed to fund the
14 Transaction. Mr. Grady recommends that financing benefits caused by the parent
15 company's method of financing the Transaction should be flowed-through to the benefit
16 of Westar's customers.²⁸

17 If one takes this position – that the financial benefits from the leveraged GPE
18 capital structure should flow through to customer rates- then from an accounting and
19 ratemaking point of view, it is necessary to include the asset funded by the capital in the
20 ratemaking process as well. Otherwise, an imbalance would exist between rate base and
21 capital structure. To correct this imbalance, the Commission would need to place the asset
22 funded (the AP) in the utility's rate base. In this scenario, the portion of goodwill

²⁷ Gatewood Direct, at 3.

²⁸ Grady Direct, at 81-82.

1 attributed to the financial benefit referred to by Mr. Gatewood should be included in rate
2 base.

3 **Q: Is Westar's and KCP&L's recovery of the AP (when using GPE's consolidated**
4 **capital structure for setting rates) supported by economic concepts as well?**

5 A: Yes. The economic principle supporting Westar's and KCP&L's recovery of the AP
6 should be given even more significance. In my testimony regarding the 1991 Merger
7 Order and proceeding, I explain the relationship between merger synergies and recovery
8 for the AP through Westar's and KCP&L's rates. The methodology involved identifying
9 merger synergies, and estimating the nominal dollar value of the after-tax financial
10 benefits which flow from synergies, over future annual periods, and calculating the net
11 present value of such annual amounts. In this Transaction, such approach would flow the
12 financial benefits related to the capital structure effect through to customers and allow for
13 recovery of the AP that caused the capital structure effect for Westar and KCP&L.

14 It needs to be remembered, of course, that Joint Applicants have proposed that the
15 AP will not be included in future utility rates and that Joint Applicants have also
16 recommended that utility rates be set on the basis of the utility capital structure, not the
17 GPE consolidated capital structure.

18 **Q: Why is it appropriate for Westar's and KCP&L's capital structure to be used to set**
19 **Westar's and KCP&L's rates rather than GPE's consolidated capital structure?**

20 A: GPE witness Mr. Robert Hevert will provide rebuttal testimony explaining that the actual
21 capital structure of Westar and KCP&L should be used for setting rates post-Transaction.
22 However, the Transaction would be in jeopardy if the Commission finds in this
23 proceeding that the consolidated capital structure for GPE should be used for setting

1 rates, unless the Commission also orders recovery for an equitable amount of the AP in
2 rates.

3 **4. Commission Precedent: Application to Recent Mergers**

4 **Q: Has the Commission issued other orders, subsequent to the 1991 Merger Order and**
5 **the 1999 Merger Order, which demonstrate that Staff's position in this case – that**
6 **the AP must be justified on the basis of merger savings – is a mis-application of the**
7 **Commission's Merger Standards?**

8 **A:** Yes. The following section addresses a number of those cases, many of which are quite
9 recent.

10 **i. Black Hills/Kansas Gas Utility Company, LLC Acquisition of Aquila, Inc.'s**
11 **Kansas Natural Gas Business and Great Plains Energy Incorporated**
12 **Acquisition of Aquila, Inc. Order (2008)**

13 **Q: Please describe the merger cases involving Black Hills/Kansas Gas Utility Company,**
14 **LLC Acquisition of Aquila, Inc.'s Kansas Natural Gas Business and Great Plains**
15 **Energy Incorporated's Acquisition of Aquila, Inc. Order.**

16 **A:** On April 4, 2007, Aquila, Inc., d/b/a Aquila Networks — KGO ("Aquila"), Black Hills
17 Corporation (Black Hills), and Black Hills/Kansas Gas Utility Company, LLC ("Black
18 Hills") filed an Application seeking Commission approval to transfer to Black Hills all
19 Aquila certificates of convenience and necessity and Aquila franchises with respect to
20 Aquila's Kansas natural gas business and operations, including regulated transmission
21 and distribution assets located in Kansas ("Aquila Kansas") in Docket No. 07-BHCG-
22 1063-ACQ ("07-1063 Merger Docket").

23 Also on April 4, 2007 GPE, KCP&L, and Aquila filed an Application seeking
24 approval for GPE to effectively acquire Aquila's Missouri electric and steam operations

1 and merchant services operations in a cash-and-stock transaction in Docket No. 07-
2 KCPE-1064-ACQ (“07-1064 Merger Docket”).²⁹

3 The dockets were consolidated, and on January 31, 2008, all parties in the 07-
4 1063 Merger Docket filed a Settlement Agreement (“07-1063 Agreement”), and on
5 February 27, 2008, all parties to the 07-1064 Docket filed a Settlement Agreement (“07-
6 1064 Agreement”).

7 **Q: Did the Commission issue an order adopting the two unanimous settlement**
8 **agreements?**

9 A: Yes. On May 15, 2008, the Commission issued “Order Granting Joint Motions to Adopt
10 Stipulation and Agreement and Approving Agreements” (“Order Granting Joint
11 Motions”). The Order Granting Joint Motions adopted the 1063 Agreement and the 1064
12 Agreement.

13 **Q: Was an AP paid in the Black Hills acquisition of Aquila Kansas?**

14 A: Yes. But, in support of the 07-1063 Agreement, Staff witness Jeff McClanahan
15 explained, “the Agreement will not allow Black Hills to recover an acquisition premium,
16 transition costs, or transaction costs through rates.”³⁰

17 **Q: Did the order mention the amount of the AP in the Black Hills’ acquisition of Aquila**
18 **Kansas?**

19 A: No. The Order Granting Joint Motions did not mention the amount of the AP, transition
20 costs or transactions costs paid in the transaction. On page 12 of the Order, the
21 Commission states, “Noting the transaction provided quantitative benefits, [Staff witness]
22 McClanahan testified that sufficient qualitative benefits exist to make the Agreement in

²⁹ Order Granting Joint Motions, page 2.

³⁰ Order Granting Joint Motions, page 12.

1 the public interest.” However, in addition to not mentioning the amount of quantitative
2 benefits, AP, transition costs or transactions costs, the order does not explain how Mr.
3 McClanahan, or the Commission, concluded the transaction was in the public interest.
4 Nor does Mr. McClanahan discuss the qualitative benefits of the transaction in relation to
5 his conclusion.

6 **Q: Does the Order Granting Joint Motions discuss the Merger Standards with respect**
7 **to the 07-1063 Agreement?**

8 A: No, the Order Granting Joint Motions does not discuss the Merger Standards. The order
9 does not explain how the order and 07-1063 Agreement comply with the Merger
10 Standards in general and, more specifically, there is no discussion about how cost savings
11 compare to the amount of AP paid. Further, the order did not find that the transaction’s
12 synergies or cost savings satisfied Merger Standards (a)(ii) and (a)(iv) using the Staff’s
13 application of those standards for the current Transaction. That is, apparently, the Black
14 Hills transaction was not subject to being denied based on perceived deficiencies in cost
15 savings relative to the size of the AP.

16 **ii. GPE’s Acquisition of Aquila (2008)**

17 **Q: Was an AP paid in the GPE acquisition of Aquila?**

18 A: Yes. The order references CURB witness, Andrea Crane’s testimony in support of the 07-
19 1064 Agreement, explaining that “the 1064 Agreement was in the public interest because
20 ratepayers retain some synergy savings, acquisition premium and transactions costs are
21 not allowed, and only about 20% of requested transition costs may be recovered.”³¹
22 Further, “Crane set forth her understanding of the 1064 Agreement and of Giles’ clarified

³¹ Order Granting Joint Motions, page 17.

1 prefiled testimony, noting that 'synergy savings will be reflected in the cost of service
2 simply as they fall' and the company will not keep those synergy savings for the benefit
3 of shareholders.”³² (Emphasis added.)

4 **Q: What were the Commission’s and Staff’s conclusions concerning the AP, merger**
5 **savings, transactions costs and transition costs for the GPE acquisition of Aquila?**

6 A: The order cites Staff witness Mr. McClanahan’s testimony that “Staff believed no
7 quantifiable merger-related savings could be determined” and “When viewed as a whole,
8 the 1064 Agreement meets Staff’s recommended no-detriment standard and may
9 provide benefits as well... [and] may help KCPL achieve some level of actual merger-
10 related cost savings that will benefit Kansas ratepayers.”³³ (Emphasis added.)

11 **Q: Did the order mention the amount of the AP in GPE’s acquisition of Aquila?**

12 A: No. The Order Granting Joint Motions did not mention the amount of the AP, transition
13 costs or transaction costs paid in the transaction.

14 **Q: Does the Order Granting Joint Motions discuss the Merger Standards with respect**
15 **to the 07-1064 Agreement?**

16 A: No. The order does not explain how the order, or the 07-1064 Agreement, comply with
17 the Merger Standards in general and, more specifically, there is no discussion about how
18 cost savings compare to the amount of AP paid. That is, as with the Black Hills
19 transaction, the GPE transaction was not subject to being denied based on perceived
20 deficiencies in cost savings relative to the size of the AP.

³² Order Granting Joint Motions , pages 17-18.

³³ Order Granting Joint Motions, page 16.

1 iii. PostRock MidContinent Production Order (2014)

2 **Q: Has the Commission rendered other decisions that did not deny merger transactions**
3 **based on the reasonableness of purchase price or an AP?**

4 A. Yes. In 2014, the Commission approved a sale of natural gas pipeline facilities and
5 related assets and transfer of a certificate of convenience and necessity³⁴. In that case, the
6 Commission used the Merger Standards to analyze the request.³⁵ Although the
7 Commission applied its Merger Standards, it did not address the purchase price or any
8 AP for reasonableness. The Commission Staff stated in its Report and Recommendation:

9 Staff found that the purchase price of the Facilities is not
10 applicable at this time given that LOG³⁶ will be operating with
11 individual customer contracts. However, in the event of a rate case
12 filed in the future, LOG shall have the burden to support the
13 valuation of the acquired Facilities and to justify any acquisition
14 premium.³⁷

15 The Commission adopted Staff's Report and Recommendation in its entirety.

16 The PostRock Order required, in the event of a rate case (sometime after the
17 transaction has already been approved), that the company shall have the burden to
18 support and justify the purchase price or AP paid. Obviously, this means the approval of
19 the transaction was entered by the Commission without determining the reasonableness
20 of the purchase price and the AP was only viewed as relevant to the extent the parties
21 were to seek recovery of the AP in rates after the transaction.

³⁴ *Re Joint Application of PostRock MidContinent Production, LLC, et al.*, Docket No. 14-EMEG-101-ACQ, 2014 Kan. PUC LEXIS 136 (Jan. 14, 2014) ("PostRock Order").

³⁵ PostRock Order, paragraph 4.

³⁶ LOG was the short form adopted by the Commission in the order for MVP Logistics, LLC. LOG was the purchaser of the pipeline from PostRock and sought both approval of the acquisition and a certificate of convenience and necessity to operate the pipeline after its acquisition.

³⁷ PostRock Order, paragraph 17.

1 **Q: Why is the PostRock Order relevant to this proceeding?**

2 A: The transaction is relevant because, as in each of the other merger dockets discussed
3 above, it indicates that the Commission's concern about the AP is focused on how much
4 of the premium should be recovered in customer's rates. Similarly, in the GPE/Westar
5 Transaction here, where the Joint Applicants have indicated they will not seek recovery
6 of the AP in rates, the Commission's concern about the purchase price or AP should not
7 include a linkage between them and the estimated cost savings from the Transaction.

8 **iv. ITC Great Plains Order (2016)**

9 **Q: Do you have any further precedential support for your suggestion that the size of**
10 **the AP relative to merger savings is “irrelevant to the determination of whether the**
11 **transaction is in the public interest”?**

12 A: Yes. The Commission recently approved the acquisition of ITC Holdings – the parent of
13 ITC Great Plains – by Fortis, Inc.³⁸ In that case, Fortis was offering a premium for ITC's
14 equity of approximately 33%.³⁹ However, as Staff stated, the transaction was not based
15 on any anticipated savings or operational synergies.⁴⁰ The Commission approved the
16 transaction stating the merger standards were satisfied because of Fortis' commitment not
17 to seek to recover the AP in ITC's rates and due to the Commission's lack of rate
18 regulatory authority over ITC.⁴¹ The Commission also states that “Since the
19 Transaction is not premised on operational synergies, whether operational synergies exist

³⁸ *Re Joint Application of ITC Great Plains, et al.*, Order Approving the Transaction with Conditions, Docket No. 16-ITCE-512-ACQ (October 11, 2016) (“ITC Merger Order”)

³⁹ ITC Merger Order, paragraph 25.

⁴⁰ ITC Merger Order, paragraph 26.

⁴¹ ITC Merger Order, paragraph 27.

1 to justify payment of a premium in excess of book value is not material in determining
2 whether the Transaction is in the public interest.”⁴²

3 By the same token, because the Joint Applicants here will not be seeking recovery
4 of the AP or transaction costs, provided Westar’s and KCP&L’s rates are based on their
5 respective capital structures post-merger, and because cost savings from the Transaction
6 will flow through to customers over time, the comparative size of the AP and merger
7 savings should not be a determining factor for the Commission approving the
8 Transaction.

9 **Q: Doesn’t the fact that ITC is not within the Commission’s ratemaking authority**
10 **make the ITC case distinguishable?**

11 A: No. Even though the Commission does not set ITC’s rates, the Commission was
12 obligated to determine the public interest when it approved the transfer of ITC’s
13 certificate of convenience and necessity to Fortis. Presumably, that is why the
14 Commission reviewed the merger and issued an order.

15 The Commission did evaluate the merger under the Merger Standards. The
16 Commission did not concern itself with the size of the AP because the transaction was
17 not premised on the existence of operational synergies. If, as the Commission found in
18 the ITC transaction, a merger which has no operational synergies or cost savings need not
19 be judged on purchase price or AP, then certainly it follows that a merger transaction
20 generating substantial synergies or cost savings, like the Transaction here, should not
21 have its purchase price or AP judged for reasonableness either. This is especially true
22 where, as here, no AP recovery is sought.

⁴² ITC Merger Order, paragraph 30.

1 v. **Liberty Utilities (Central)/Empire District Electric Company Order (2016)**

2 **Q: Did the Commission evaluate the reasonableness of the purchase price in the recent**
3 **merger of Liberty Utilities (Central) Co. and Empire District Electric Company?**

4 A: Yes. On December 22, 2016, the Commission issued its Order Granting Joint Motion to
5 Approve the Unanimous Settlement Agreement and Approval of the Joint Application
6 (“Empire Merger Order”). In the Empire Merger Order, the Commission adopted its
7 Staff’s conclusions and recommendations concerning the purchase price and AP paid by
8 Liberty Utilities (Central) Co (“Liberty”) for the common equity of Empire District
9 Electric Company (“Empire”).⁴³

10 The Commission evaluated the purchase price and AP under Merger Standards
11 (a)(ii) and (a)(iv) for reasonableness. With respect to Merger Standard (a)(ii), the
12 Commission found, based on its Staff’s testimony, that “the purchase price agreed to be
13 paid by Algonquin for Empire's stock could not be determined to be reasonable in light of
14 the savings demonstrated by the Transaction.”⁴⁴ Further, with respect to Merger Standard
15 (a)(iv), the Commission found, based on its Staff’s testimony, that “there are not
16 operational savings which justify the payment of the Acquisition Premium (AP) over
17 book value.”⁴⁵ Notwithstanding these findings concerning the reasonableness of the
18 purchase price and AP, the Commission adopted Staff’s recommendation and concluded
19 “the purchase price itself was not unreasonable and that because the Merger Conditions
20 result in quantified net benefit to ratepayers, the Transaction is in the public interest.”⁴⁶

⁴³ Liberty is an indirect subsidiary of Algonquin Power & Utilities Corp. (Algonquin)

⁴⁴ Empire Merger Order, page 11.

⁴⁵ Empire Merger Order, page 13.

⁴⁶ Empire Merger Order, page 12.

1 **Q: What is the “quantified net benefit to ratepayers” the Commission refers to in the**
2 **Empire Merger Order?**

3 A: In the Empire Merger Order, the Commission refers to the Staff testimony of Mr. Grady
4 and finds “Staff attests to the quantifiable benefit for ratepayers resulting from the rate
5 making provisions. Staff calculated a positive net present value (NPV) customer benefit
6 of \$5.77 million associated with this Transaction, as modified by the Agreement, or \$597
7 per Kansas customer.”⁴⁷ Largely, the benefit is derived from a rate moratorium agreed to
8 by Liberty.

9 **Q: So, the Commission did not deny the Empire merger transaction even though they**
10 **found insufficient cost savings from the transaction to support the purchase price?**

11 A: Correct.

12 **Q: Why is the Commission decision in the Empire Merger Order significant to the**
13 **current Transaction here?**

14 A: First, it is significant because the Empire Merger Order was just issued on December 22,
15 2016. So, it is timely with respect to the current Transaction. But, more importantly, it
16 provides another precedent in which the Commission has not denied a merger transaction
17 when the net present value of cost savings from merger synergies are less than the AP
18 included in the purchase price.

19 Notwithstanding the recent Commission decision in the Empire Merger Order,
20 Mr. Grady recommends the current Transaction be denied because there are not
21 operational savings that justify the payment of the AP over book value. Mr. Grady’s
22 recommendation should be rejected by the Commission because of its recent ruling in the

⁴⁷ Empire Merger Order, page12.

1 Empire Merger Order and the other similar rulings in the orders I have discussed above
2 and the underlying rationale in those decisions remains sound.

3 **Q: Does Staff's recommendation that the current Transaction be denied due to the**
4 **merger savings being less than the AP represent a proposed change to the Merger**
5 **Standards?**

6 A: Yes. I am not aware of any case in which the Commission has denied a utility merger
7 transaction due to the estimated merger savings being less than the AP. In the
8 Liberty/Empire merger Staff apparently came close to recommending that merger be
9 denied because of Mr. Grady's finding that there were not operational savings justifying
10 the payment of the AP over book value. That is, based on a read of Mr. Grady's
11 testimony (and the Empire Merger Order) in the Liberty/Empire merger, absent Liberty
12 agreeing to the rate moratorium, Staff would have declared the purchase price and AP
13 unreasonable and thus recommended the transaction be denied because the proposed
14 transaction would otherwise have provided no benefit to customers.⁴⁸

15 In this merger case, however, Staff recommends the GPE-Westar Transaction be
16 denied by the Commission due to the size of the AP and purchase price. Based on my
17 knowledge of the history of utility mergers presented before the KCC, I believe if the
18 Commission were to deny the Transaction here on that basis it would represent a stark
19 change in the application of the Merger Standards.

⁴⁸ However, the logic of that finding and recommendation seems lacking. If the purchase price and AP are unreasonable in light of estimated merger savings, then requiring Empire to defer a rate increase through a moratorium should make it more difficult for the purchase price and AP to be deemed reasonable. That is, the net present value of cash flow for Empire becomes less due to the moratorium thus decreasing its enterprise value. It is unknown whether Staff would have actually taken this position because Staff's testimony was filed after the Settlement was reached, making the claim gratuitous on Staff's part and of no import in that case.

IV. GAIN ON SALE

1 **Q: Staff Witness Justin T. Grady recommends crediting a portion of the AP to**
2 **customers.⁴⁹ Can the Commission require Westar's shareholders to share a portion**
3 **of the gain on the sale of their stock with Westar's customers?**

4 **A:** Not to my knowledge. I am not aware of any way the Commission can exert authority
5 over Westar's shareholders and redistribute a portion of their proceeds from the
6 Transaction to customers.

7 **Q: If the Commission cannot implement a forced redistribution of a portion of the**
8 **proceeds from the Transaction from Westar's shareholders to Westar's customers,**
9 **what would be the source of the funds to implement Staff's sharing proposal?**

10 **A:** The funds would have to come from Westar's or KCP&L's cash flow, or GPE's other
11 cash flow, post-Transaction. Under Mr. Grady's proposal, GPE would pay; (a) the \$4.9
12 billion AP to Westar's shareholders; (b) an additional \$1.68 billion to Westar's customers
13 under his "sharing" proposal; (c) flow additional merger savings to customers through the
14 ratemaking process over time, and (d) not request customers pay for any of the AP or
15 Transaction costs in rates.

16 **Q: Is Staff's recommendation to, in effect, impose a \$1.68 billion tax on the Transaction**
17 **the result of a misapplication of the regulatory policy often used for the sharing of**
18 **gain on sale of utility assets?**

19 **A:** Yes. If the transaction before the Commission in this docket involved Westar's sale of
20 one or more utility assets to GPE or KCP&L in which the company received cash or
21 assets Staff's recommendation would be a relevant debate to be had. For example, if
22 Westar were selling a generation unit to KCP&L, and Westar received more than the net

⁴⁹ Grady Direct, at 83.

1 depreciated original cost for that asset, then it would be within the Commission's
2 jurisdiction and responsibility to determine the appropriate sharing of that gain among
3 Westar and Westar's customers and Westar would have cash proceeds from the sale
4 available to fund any proposed sharing. However, as I stated previously, the cash and
5 other proceeds of this Transaction will go to Westar's shareholders. Neither Westar,
6 KCP&L nor GPE will receive cash, or any other consideration from the Transaction, that
7 can be used to fund Mr. Grady's proposed payment to Westar's customers.

8 **Q: If Westar sold utility assets above net depreciated original cost would Westar**
9 **actually receive and record the gain?**

10 A: Yes, under the hypothetical assumption that Westar sold utility assets above net
11 depreciated original cost, Westar, not its shareholders, would receive consideration that
12 would be recorded to an income account in its financial statements. The consideration
13 recorded to revenue would be the portion of the consideration received by Westar that
14 exceeded the net depreciated book value of the asset sold. The cash, or consideration
15 received in this hypothetical transaction, would actually benefit Westar, the company,
16 unlike the consideration received in this Transaction by Westar's shareholders.

17 **Q: Why could the Commission decide to require Westar to share the gain on the sale of**
18 **utility assets with its customers?**

19 A: Generally, the argument supporting the sharing of a gain on the sale of utility assets with
20 customers follows the reasoning that the cost of service attributable to the asset was
21 recovered through the selling utility's rates prior to its sale and removal from its rate
22 base. Specifically, the utility rates include recovery of: (a) a return to the utility of its
23 investment in the assets, through recovery of depreciation expense from customers;
24 operating and maintenance expenses, property taxes and insurance; and (b) a full rate of

1 return on the un-depreciated balance of the assets until such investment is fully recovered
2 through rates, or until sold, from customers. Further, Commissions may find the rate of
3 return compensates the selling utility: (a) for the business and financial risks incurred
4 with respect to its equity investment in the asset; and, (b) for the weighted-average cost of
5 debt, in funding its investment in the assets.

6 **Q: Are you familiar with a Kansas Court of Appeals case that deals with the gain on**
7 **the sale of utility assets?**

8 A: Yes. On November 16, 1979, KPL filed an application with the KCC for permission to
9 put into effect rates that would increase gross revenues of its natural gas operations. An
10 issue in the rate case involved the ratemaking treatment for the gain on the sale of KPL's
11 Salina, Kansas office building. In its application, KPL did not make an adjustment to
12 credit any portion of that to its customers.

13 On June 2, 1980, the KCC issued an order reversing KPL's treatment for the gain
14 and, thus, providing the entire benefit from the gain to the customers. KPL appealed the
15 KCC decision to the Court of Appeals of Kansas.⁵⁰ In the *KPL* case, the Kansas Court of
16 Appeals held that "it was unreasonable for the Commission to allocate to customers all of
17 the benefit of capital gain realized from the sale of the utility's office building."
18 However, the Court found the KCC could allow shareholders and customers to share in
19 the gain of the sale of an office building by the utility based upon a five-factor test.

⁵⁰ *Kansas Power & Light Company v. State Corporation Commission*, 5 Kan. App. 2d 514, 620 P. 2d 329 (1980) (*KPL*).

1 **Q: How is the Transaction here distinguishable from the KPL office building case**
2 **discussed above?**

3 A: The current Transaction is distinguishable from the *KPL* case in that: (1) The Transaction
4 involves the acquisition of shareholders' common stock while the *KPL* case involved the
5 sale of a single utility asset; and, (2) The Transaction involves the acquisition of an entire
6 utility business while the *KPL* case involved the sale of utility assets.

7 **Q: Does the *KPL* case apply to the facts in the Transaction?**

8 A: No. The factors identified by the Kansas Court of Appeals in the *KPL* case that are to be
9 used to allocate the gain on the sale by an ongoing entity of utility assets between
10 shareholders and customers clearly are not applicable to the sale of shareholders'
11 common stock or the sale of the shareholders' investment in an entire utility business.

12 Clearly, the Court is discussing capital gains retained by the utility in the *KPL*
13 case. In this Transaction, Westar, the utility, does not receive or retain a capital gain, thus
14 Westar has no gain to share with customers. The capital gain is received and retained by
15 Westar's shareholders, therefore, the findings of the *KPL* case do not apply here.

V. MERGER SAVINGS

16 **Q: Have the Joint-Applicants estimated merger savings generated from merger**
17 **synergies post-Transaction?**

18 A: Yes. Joint Applicants' witness Mr. William J. Kemp has quantified a significant level of
19 non-fuel operations and maintenance related savings achievable with the Transaction. Mr.
20 Kemp estimates GPE Transaction-related non-fuel savings of approximately \$486.0
21 million over a 3.5-year period from mid-2017 to the end of 2020.⁵¹ Based on GPE's

⁵¹ Mr. Kemp is providing updated estimates of merger savings in his rebuttal testimony.

1 estimate of synergies, GPE expects that the transaction-related savings of nearly \$200
2 million per year that are expected to be achieved by the end of calendar year 2020 will
3 continue in 2021 and beyond. After taking into account an estimated \$60 million in costs
4 necessary to achieve the savings, one finds a net savings for the initial period (2017
5 through 2020) of approximately \$426 million.

6 This is the estimated revenue requirement impact from non-fuel operations and
7 maintenance expense savings and additional cost savings related to capital expenditure
8 reductions. The cost savings, net of costs directly incurred to achieve such savings during
9 a test year, will be fully reflected in the respective revenue requirements used for
10 determining utility rates of Westar's and KCP&L's customers through the ratemaking
11 process. Cost savings related to Westar's and KCP&L's utility business retained by GPE
12 solely result from regulatory lag and the nature of the regulatory process.

13 **Q: Do Staff witnesses criticize the Joint-Applicants quantification of cost savings?**

14 A: Yes. Each of Staff's witnesses Mr. Jeffrey McClanahan, Ms. Ann Diggs, Mr. Justin
15 Grady, Mr. Scott Hempling and Dr. Robert Glass criticize the merger savings estimates
16 provided by Mr. Kemp. The central theme of Staff's argument is that there is an
17 insignificant amount of quantifiable and demonstrable savings generated from merger
18 synergies and the savings which do exist will largely be kept from customers until future
19 rate cases evolve. Joint-Applicants' witnesses Mr. Steven Busser, Mr. William Kemp
20 and Mr. Thomas Flaherty will provide detailed Rebuttal Testimony to Staff's witnesses.

21 **Q: Have previous Commission orders held merging companies to such a high level of**
22 **scrutiny for demonstrating merger savings?**

23 A: No. As in this case, in the 1991 merger there was a significant disagreement between the
24 Applicants and other parties concerning the savings that could reasonably be anticipated

1 to result from the merger. As the Commission noted in its 1991 Merger Order, estimates
2 for the net present value of anticipated savings varied widely “from Applicants’ \$705
3 million to Staff’s \$226 million.” The Commission went through sequences of averaging
4 estimates of Commission Staff, CURB and the Applicants (KPL and KGE) and in its
5 final average, ultimately, the Commission determined that a reasonable estimate of
6 merger savings was in the range of \$306 to \$315 million. Taking this into account, the
7 Commission stated “The Commission finds that a reasonable AP is \$312 million, which
8 is the average of the midpoints.”⁵²

9 It is apparent that the series of averaging procedures applied by the Commission
10 in the 1991 Merger Order was not scientifically or mathematically linked to any specific
11 factual calculation of savings estimates or level of guarantee. That is, the actual estimates
12 varied between \$226 million and \$705 million. Yet, the Commission approved the
13 merger transaction before it after deeming the savings to be \$312 million.

14 As with the 1991 merger, many of the other orders discussed here similarly did
15 not establish a stringent standard for demonstrated savings. For example, the 1999
16 Merger Order, for the merger of WRI and KCP&L; the merger case involving Black
17 Hills/Kansas Gas Utility Company, LLC Acquisition of Aquila, Inc.’s Kansas Natural
18 Gas Business; and Great Plains Energy Incorporated’s Acquisition of Aquila, Inc. Orders
19 did not require a direct tie between anticipated savings and the acquisition adjustment
20 incurred in the transaction.

⁵² 1991 Merger Order, page 60.

1 **Q: What level of proof of merger savings has the Commission required in past cases?**

2 A: Historically, to the extent the Commission has discussed the amounts of expected
3 savings, it has relied upon precisely the types of studies and estimates GPE has presented
4 in this case.

5 **Q: Can you provide examples?**

6 A: Sure. In the 1991 Merger Order, the Commission relied upon a financial model devised
7 by Deloitte & Touche (and sponsored by Tom Flaherty – one of GPE’s rebuttal witnesses
8 in this case).⁵³ And the Commission accepted preliminary estimates and “less
9 quantifiable benefits” in approving the transaction. Thus, it stated:

10 Costs will be kept lower than they would have been without the
11 merger. Cost saving opportunities have been preliminarily
12 identified in several broad areas attributable to: (1) cross over
13 service; (2) the combining of key portions of the companies’
14 electric operations; (3) administrative and general cost savings
15 resulting from economies of scale and the elimination of duplicate
16 activities; and (4) cost avoidance opportunities for the merged
17 company in the future. Less quantifiable benefits are in the areas of
18 economies of scale in ‘financing, service quality, customer
19 convenience and enhanced opportunity for economic
20 development.’⁵⁴

21 In the proposed WRI/KCP&L merger which led to the 1999 Merger Order, the
22 Commission accepted the merger savings projection of \$1.027 billion over ten years,
23 which was again provided by Mr. Flaherty.⁵⁵ Based on Mr. Flaherty’s study, the
24 Commission stated, “the savings and benefits from the merger are one of the primary
25 reasons why the merger is in the public interest.”⁵⁶ Mr. Flaherty’s study in the
26 WRI/KCP&L matter was similar to the analysis the analysis he performed and which the

⁵³ 1991 Merger Order, at 16.

⁵⁴ *Id.* at 16-17.

⁵⁵ WRI/KCP&L Order, at ¶ 26

⁵⁶ *Id.* at ¶ 28.

Commission accepted in the 1991 Merger Order. And both of those analyses by Mr. Flaherty were very similar to the approach taken by GPE to estimate merger savings for this Transaction as Mr. Kemp explains in his direct and rebuttal testimonies.

Q: If the Commission denies the merger do you believe Westar's and KCP&L's Kansas customers' rates will be higher than with approval of the Transaction?

A: Yes. While Staff's witnesses and Joint Applicants' witnesses may differ on the amount of merger savings, it is evident that there will be significant savings post-Transaction. That is, Staff has not provided evidence that post-Transaction costs will be greater with the merger, nor have they demonstrated that all of the Joint-Applicants estimates are flawed. Those savings net of costs to achieve them, and other than amounts retained by Westar and KCP&L via regulatory lag, will be flowed through to customers.

VI. CONCLUSIONS

Q: Please summarize your key conclusions?

A: Following the lead of its consultant, Mr. Hempling, Staff has applied the Commission's Merger Standards in a way that has never been done before. As I testified, the Commission has never ruled that anticipated merger savings must equal or exceed the acquisition premium to be paid in the transaction. In fact, in a case such as this, where the Joint Applicants have not proposed to recover any of the AP in rates, the relationship between savings and the AP is irrelevant to the application of Merger Standards (a)(ii) and (a)(iv).

Further, the Commission has never established a requirement that any minimum percentage amount of the AP must be offset by merger savings. No conditional relationship at all between merger approval and purchase price or AP has been

1 established in any Commission order. In fact, the Commission has recently approved
2 transactions in which little or no merger synergies were anticipated.

3 Staff's proposal to "share" the AP or control premium is also unprecedented and
4 unsupported by the nature of the Transaction. Unlike a sale of utility assets, neither
5 Westar nor GPE will receive anything that can be shared with customers. All proceeds of
6 the Transaction are paid to Westar shareholders. Staff's proposed "sharing" would, in
7 essence, assess a tax on the Transaction with the proceeds being distributed to customers.
8 Staff's proposal would increase the payment by GPE in the Transaction by \$1.68 billion
9 dollars and kill the Transaction.

10 Given the Joint Applicants' commitment not to seek recovery of the AP in rates,
11 there is no basis for using the GPE consolidated capital structure in the utility ratemaking
12 process after the merger. If, however, the Commission were to rule that the financial
13 benefits from the leveraged GPE capital structure are to flow through to customer rates
14 then from an accounting and economic point of view, it would be necessary to include the
15 asset funded by the capital in the ratemaking process as well. Otherwise, an imbalance
16 would exist between rate base and capital structure. To correct this imbalance, the
17 Commission would need to place the asset funded by the associated financing (the AP) in
18 the utility's rate base.

19 **Q: Does this conclude your Rebuttal Testimony?**

20 **A:** Yes, it does.

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

**In the Matter of the Application of Great
Plains Energy Incorporated, Kansas City
Power & Light Company, and Westar Energy,
Inc. for approval of the Acquisition of Westar
Energy, Inc. by Great Plains Energy
Incorporated**)
)
) **Docket No. 16-KCPE-593-ACQ**
)
)
)

AFFIDAVIT OF JAMES M. PROCTOR

STATE OF DOUGLAS)
) ss
COUNTY OF KANSAS)

James M. Proctor, being first duly sworn on his oath, states:

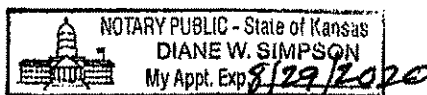
1. My name is James M. Proctor and my business address is 5555 West 6th Street, Suite Q5, Lawrence, Kansas 66049. I have been retained to serve as an expert witness to provide testimony on behalf of Great Plains Energy Incorporated and Kansas City Power & Light Company.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Great Plains Energy Incorporated and Kansas City Power & Light Company consisting of forty (40) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

James M. Proctor
James M. Proctor

Subscribed and sworn before me this 4th day of January 2017.



Diane W. Simpson
Notary Public

My commission expires: 8/29/2020

Position

President
James Proctor Consulting

Education

MBA - Corporate Finance and
Operations Research and Quantitative
and Statistical Analysis
University of Kansas

B.B.A. - Accounting and Mathematics
Washburn University of Topeka, Kansas

Regulatory Appearances

Council of the City of New Orleans,
Louisiana
Kansas Corporation Commission
Oklahoma Corporation Commission

Place of Domicile

Lawrence, Kansas

Mr. Proctor has thirty-three years of experience in the regulation of public utility companies for two state utility commissions and as a regulatory consultant to state regulatory agencies and regulated utilities. Previously Mr. Proctor was Director of the Public Utility Division of the Oklahoma Corporation Commission ("OCC") and Chief of Accounting and Financial Analysis for the Kansas Corporation Commission ("KCC").

While Director of the OCC Staff, he directed staff's development and presentation of financial, accounting and policy recommendations before the OCC in the regulation of natural gas, electric and telecommunication utilities. He also provided testimony before the Oklahoma legislature regarding utility regulation and initiated and designed the restructuring of the Public Utility Division of the OCC. Mr. Proctor provided and directed the preparation of staff testimony and reports on complex issues in utility rate cases, cogeneration cases, alternative forms of regulation, mergers and other business combinations and asset sales, corporate structure, affiliate transactions and other causes before the OCC. Mr. Proctor also hired OCC staff and prepared training sessions for OCC employees regarding regulatory policy, utility ratemaking, accounting and financial issues.

As Chief of Accounting and Financial Analysis for the KCC, he drafted testimony on complex issues, managed the preparation of other accounting staff testimony and provided communication before the commission related to regulatory matters involving policy, accounting, financial analysis and quantitative analysis. Mr. Proctor also hired KCC staff and prepared training sessions for KCC employees regarding utility ratemaking, accounting and financial issues. He provided testimony before the Kansas legislature regarding pending utility regulation.

Mr. Proctor's consulting activities have mostly been on behalf of electric and natural gas utilities. Such work on behalf of regulated utilities has largely involved preparing reports, memorandums, financial and economic analyses, discovery, conducting research, undertaking communication with various state and federal regulatory bodies and drafting testimony and preparing exhibits for management and management's consulting witnesses. Often, such work has involved financial analyses and drafting testimony regarding independent power production and utility mergers and acquisitions. Other services pertained to valuation of smart grid assets; electric transmission and wind farm assets; acquisitions of individual utility assets such as production facilities; and, the financial viability of new coal generation construction. Also, he has provided reports and recommendations regarding state and federal regulation of transmission

and legal separation of non-utility assets from utility assets through redesigning diversified corporate structure into holding company structure.

Mr. Proctor's consulting services included being Director, Regulatory Policy and Analysis of EnerTran Technology Company. Enertran was an unregulated subsidiary of Central and Southwest, a diversified electric utility. Mr. Proctor was responsible for developing strategic regulatory policy and financial analyses and assisting EnerTran's principles in various aspects of the development of non-utility power generation projects in Minnesota, Illinois and Wisconsin. Also, he represented EnerTran before the state commissions of Minnesota, Illinois and Wisconsin.

Mr. Proctor's consulting services to regulatory agencies has included many diverse topics. Such topics have included alternative forms of regulation, legal separation of non-utility assets from utility assets through corporate structure transformation to holding company format, utility and non-utility allocations for investments and costs, formula rate plans, price regulation, cost of capital, working capital, utility merger valuations, utility divestitures and reorganizations, utility bankruptcy, valuation of non-utility assets and miscellaneous other regulatory policy and ratemaking matters. Mr. Proctor has prepared many financial analyses and comprehensive studies and reports for the KCC concerning complex financial transactions involving Westar Energy, Kansas Gas & Electric Company,

Great Plains Energy, Inc., Kansas City Power & Light Company, Utilicorp United and Aquila. Such reports and analyses were instrumental in Westar Energy's and Aquila's divestiture of utility and non-utility businesses. With respect to Aquila, Mr. Proctor's financial analyses and divestiture recommendations involved the valuation of international utility and non-utility investments in Western Europe, Canada, England, Australia and New Zealand.